No. 16,109

In the United States Court of Appeals for the Ninth Circuit

MARGARET LILLIAN FERGUSON, NEWTON IVAN SHERRY and LOIS SHERRY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decisions of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

CHARLES K. RICE,
Assistant Attorney General.

LEE A. JACKSON,
I. HENRY KUTZ,
DAVIS W. MORTON, JR.,
Attorneys,
Department of Justice,
Washington 25, D. C.

INDEX

CITATIONS

In the United States Court of Appeals for the Ninth Circuit

No. 16,109

MARGARET LILLIAN FERGUSON, NEWTON IVAN SHERRY and LOIS SHERRY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decisions of the Tax Court of the United States

---

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court (R. 49-61) is not officially reported.

JURISDICTION

This appeal involves individual income tax deficiencies in the amount of $101,341.78, determined against petitioners for their calendar years, 1945 and 1946, as follows (R. 61, 62):

	1945	1946	Total
Margaret Lillian Ferguson [1]	$ 5,124.55	$45,333.52	$ 50,458.07
Newton Ivan Sherry [1] and Lois Sherry	5,123.17	45,760.54	50,883.71
	$10,247.72	$91,094.06	$101,341.78

Notice of the deficiencies was mailed to the taxpayers on October 28, 1954. (R. 9-17, 30-36.) On January 24, 1955, within the permitted ninety-day period, the taxpayers filed petitions for review with the Tax Court for a redetermination of the deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 5-17, 26-36.) The Commissioner filed answers (R. 17-23, 37-43); the taxpayers filed replies (R. 24-25, 43-45); and a hearing was held on April 15, 1957 (R. 66-196). The decisions of the Tax Court, sustaining the income tax deficiencies for calendar years 1945 and 1946, were entered on May 19, 1958.) (R. 61, 62.) Petition for review by this Court was timely filed on June 16, 1958. (R. 63-65.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Did the Tax Court err in finding and concluding, under the entire record, that the taxpayers, Newton

---

[1] Margaret Lillian Ferguson and Newton Ivan Sherry will hereafter sometimes be called the taxpayers. Lois Sherry's only interest is derived by reason of the fact that, as Newton's wife, she joined with him in filing joint income tax returns for the years in issue.

Sherry and Margaret Ferguson (a brother and sister), were partners in Sherry Enterprises, a family partnership, during its fiscal years ended June 30, 1945, and 1946, so as to be liable for income tax deficiencies assessed for their respective calendar years, 1945 and 1946 ?

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual * * * tax * * * .

(26 U.S.C. 1952 ed., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1952 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U.S.C. 1952 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * *

(2) *Partnership and partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * *

(26 U.S.C. 1952 ed., Sec. 3797.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> Sec. 29.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * * .
>
> * * * *

STATEMENT

The pertinent facts, as stipulated (R. 46-49) and found by the court (R. 50-58), appear, as follows:

The taxpayers Newton Ivan Sherry and Margaret Lillian Ferguson are the children of Nathan Sherry. Nathan's first wife, the mother of Newton and Margaret, died in 1937. In 1938 Nathan married Lucille Lawler Sherry. Nathan died in 1954. Lois Sherry is the wife of Newton, and, aside from the fact that she filed joint returns with Newton, has no connection with the issue here involved. (R. 50.)

The taxpayers' returns for the calendar years 1945 and 1946 were filed with the Collector of Internal Revenue for the Sixth District of California. (R. 51.)

Nathan, after discussions with his lawyer and his accountants, had his lawyer draft a partnership agreement dated October 1, 1943 (R. 48), which stated in part (R. 51-52):

Whereas, First Parties [Nathan and Lucille] were married on the first day of April, 1938 and ever since said date have been and now are husband and wife; and

Whereas, since said marriage First Parties have acquired and now own and hold the hereinafter described properties as community property; and

Whereas, First Parties acquired all of said properties by and through their joint and several personal services actually rendered since the date of said marriage; and

That said properties are described as follows:

50% interest of S & P Company valued at $30,000.00;

25% interest of Hollywood Recreation Company valued at $25,000.00;

100% interest of Hollyway Cafe valued at $5,000.00;

50% interest of Monticello Cafe valued at $4,500.00;

33⅓% interest of Pago Cafe valued at $3,000.00;

12½% interest of Swing Club valued at $1,500.00; and

Whereas, Second Parties are the children of Nathan Sherry by a former marriage, and there are no children the issue of said marriage of First Parties. and

Whereas, First Parties desire to give and transfer to Second Parties one-half of their interest in the aforedescribed properties for the purpose of creating a partnership between and including all and every of parties hereto,

Now, Therefore, Be It Known By These Presents:

> That the parties hereto will become and remain partners for a term of one year if each and all of them shall so long live, and for and during such additional time as each and all shall so desire;
>
> * * * *

The S & P Company (hereinafter referred to as "S & P") owned and operated bars and restaurants. Paul Kalmanovitz owned the remaining 50 per cent interest in S & P. (R. 52.)

The partnership agreement, along with a letter requesting their signatures, was mailed to Newton, who was then on Guadalcanal as a member of the United States Marines, and to Margaret who was then stationed in Ohio as a member of the United States Navy. They, in turn, signed the agreement and mailed it back to their father who was in Los Angeles. At the time they signed the agreement Newton was twenty-three and Margaret was twenty. (R. 52.)

Nathan and Lucille filed gift tax returns dated March 15, 1944 (R. 48-49), for the year 1943 on which they each reported gifts of one-half the property transferred to the new firm. Margaret signed donee returns dated March 15, 1944, in connection therewith. Nathan signed donee returns as attorney in fact for Newton. (R. 52-53.)

The parties to the original agreement signed an amendment thereto (R. 48) dated July 1, 1944. This amendment stated that the firm's losses were to be borne in equal shares by the parties to the agreement. The amendment indicates that the firm was named

Sherry Enterprises (hereinafter referred to as "Enterprises"). (R. 53.)

Newton was on active duty with the Marines from January 1940 until May 1945. He returned to the United States in March 1945, and was in a hospital in Philadelphia, Pennsylvania, from then until May 1945. Margaret was on active duty with the Navy from February 1943 until November 1945. (R. 53.)

Throughout the period relevant to this proceeding Nathan possessed a power of attorney to act in behalf of Newton and Margaret. (R. 53.)

Partnership returns (R. 48) for Enterprises for fiscal years beginning July 1, 1944, and ending June 30, 1945, and beginning July 1, 1945, and ending June 30, 1946, dated September 13, 1945, and September 3, 1946, respectively, were signed by Nathan. The taxpayers did not examine, sign or have anything to do with the preparation of these returns. Their preparation and filing were carried out under Nathan's direction. (R. 53.)

At Nathan's direction accountants prepared the individual returns of Newton (R. 48) and Margaret (Respondent's Ex. A and B, Stip., par. 5, R. 48) for the calendar years 1945 and 1946. These returns disclosed that Newton and Margaret each had $21,599.28 of income from Enterprises in 1945 and $19,156.85 in 1946. The taxpayers signed their respective 1945 returns on March 13, 1946. The returns for 1946, signed by the taxpayers, were received in the office of the Collector of Internal Revenue on March 15, 1947. Nathan saw to the preparation and filing of these returns and also arranged for the pay-

ment of the tax shown to be owing on the returns. (R. 53-54.)

Newton enrolled in college for the fall semester of 1945, but dropped out before completion of the semester in order to work for S & P. This was done in response to directions from Nathan. Newton was employed by S & P as manager of a drive-in and bar known as the Bayview Club. His salary was $110 per week. This job ended sometime in 1946. At no time during this employment did Newton have anything to do with the keeping of the books and records of the Bayview Club. (R. 54.)

In 1946 Newton purchased a home for $8,599. The money for this purchase was given to him by his father. The house was sold later in that same year and the money was returned to Nathan. Newton always considered that the house belonged to Enterprises. (R. 54.)

Margaret attended college during the spring semester of 1946. In the fall of that year she worked as an office girl in a perfume business named Sherry Dunn. Margaret believed that this business was owned by Enterprises. (R. 54.)

At Nathan's request Margaret sometimes made deposits and withdrawals for him at various banks. At some of these banks the accounts were in the joint names of Margaret and Nathan. During the period in which Margaret lived in her father's home she drew on these accounts to meet their household expenses. Margaret was married in March 1947 and ceased to live in her father's home. (R. 54-55.)

At the time of their mother's death and in the years following, Newton and Margaret were under the impression that their mother had left them $20,000 in the care of their father. It was their belief that Nathan used this money in his business, and that it was part of the capital of Enterprises. (R. 55.)

Sometime after their discharge from the Armed Forces Newton and Margaret each received approximately $500 as a result of the death of a grandparent. They turned this money over to Nathan to be used in Enterprises. (R. 55.)

In 1945 real property valued at approximately $52,500 was placed in Margaret's name. In 1946 real property valued at approximately $2,500 was also placed in her name. All of this property was placed in her name at Nathan's direction. Margaret did not consider herself the owner of this property. She thought it belonged to Enterprises. (R. 55.)

In 1947 Nathan transferred stock in the Marguery Corporation, which operates Lucy's restaurant, to Margaret. Nathan had purchased this business with funds from Enterprises. Margaret, at the time of the transfer from her father, considered herself the owner of the transferred shares. For a time Margaret was president of the corporation; at the time of the trial she managed the restaurant and owned 20 per cent of the corporation's outstanding stock. (R. 55-56.)

Margaret is the record owner of a "fourplex" apartment house valued at approximately $14,000. Her rights in this property were transferred to her

by her father. It was subject to an existing attorney's lien, and there is now an outstanding "assignment" of her rights in this property. (R. 56.)

Margaret is the owner of a "triplex" apartment house valued at approximately $35,000. This house belonged to Enterprises prior to its transfer to Margaret in 1950. Since the transfer of the "triplex" Margaret has made all the mortgage payments thereon. (R. 56.)

Newton and his wife signed a "Waiver of Restrictions on the Assessment and Collection of Deficiency in Tax (Form 870) dated July 19, 1948, for the year 1945 (R. 100, 196), for the amount of $1,114.42. (See Stip. par. 4, R. 47-48.) The address under their signatures is 5444 Melrose Avenue, Los Angeles. Lucy's Restaurant is located at that address. In a letter dated September 9, 1948, mailed to the Melrose Avenue address, the Commissioner indicated that the deficiency was caused by an increase in Newton's distributive share of Enterprises' income. (R. 56.)

On November 2, 1949, in the course of the Internal Revenue Service's investigation of Nathan's income, Newton testified under oath (Stip. by Counsel, R. 102, 185, 186) that he was then a partner in Enterprises. (R. 56.)

Margaret signed a "Waiver of Restrictions on Assessment and Collection of Deficiency in Tax" (R. 139, 196), dated July 1948, for the year 1945 for the amount of $1,109.75. The address under Margaret's signature was 5444 Melrose Avenue, Los Angeles. In a letter dated September 9, 1948, mailed to the Melrose Avenue address, the Commissioner

indicated that the deficiency was caused by an increase in Margaret's distributive share of Enterprises' income. (R. 56-57.)

On May 15, 1950, in the course of the Internal Revenue Service's investigation of Nathan's income, Margaret testified under oath (R. 141, 142) that she was then a partner in Enterprises. (R. 57.)

In 1947 S & P was dissolved. Neither Newton nor Margaret had any connection with the negotiations leading to a division of that company's property. (R. 57.)

One of the former S & P properties not taken by Paul Kalmanovitz upon dissolution of that company was the Clover Club and its underlying real property. This property was placed in a trust the beneficiaries of which were Newton and Margaret. The trustee of this trust was an accountant employed by Nathan. The Clover Club was later destroyed by fire. Subsequently this property was sold. Nathan received the proceeds of the sale. The trustee did nothing to protect the interests of the beneficiaries. Nathan was in control of Enterprises; however, at various times he, his wife, Newton and Margaret held informal meetings at which Enterprises' business was discussed. (R. 57.)

The earliest that Paul Kalmanovitz heard of the existence of Enterprises was 1947. (R. 57.)

Newton and Margaret never asked to examine, or examined any of the books or records of Enterprises or of S & P. Nor did they ever request an accounting in connection with either of these firms. (R. 58.)

The Commissioner increased the income of Sherry

Enterprises for the years relevant to the taxpayers' taxable years 1945 and 1946, and accordingly increased their distributive shares and their income taxes for those years. (R. 58.)

The taxpayers Newton and Margaret were partners in Sherry Enterprises during the years in question. (R. 58.)

SUMMARY OF ARGUMENT

The Tax Court correctly found and concluded, under this entire record, that Newton Sherry, the son of Nathan Sherry, deceased, and Margaret Ferguson, the daughter, were partners of Sherry Enterprises, a family partnership, during the taxable years 1945 and 1946.

Unlike the familiar family partnership federal tax controversy wherein the taxpayer is endeavoring to establish validity of the business organization form in question, this case presents the *reverse issue* of an existing partnership, organized and held out as valid by the taxpayers and other family members, throughout the taxable period, but now disavowed and claimed by them to have never possessed validity. In such circumstances, the controlling legal principles are well settled that: (a) the Commissioner can elect to rely on the validity of the family partnership organizational form which the taxpayers have themselves created; and (b) the burden is on the taxpayers, who are disavowing the existence of their own partnership, to prove that no valid family partnership ever existed. Under the agreed facts here obtaining, the Tax Court had more than ample justi-

fication for finding and concluding that these taxpayers failed completely to sustain their burden. Such a finding is, of course, entitled to finality where, as here, it is supported by substantial evidence and is not shown by the taxpayers to be clearly erroneous.

No question here exists as to the formation of the partnership on October 1, 1943, and as to its operation throughout and during the taxable years 1945 and 1946. At the time of formation both Newton and Margaret were on active duty in the armed forces. However, both admitted they signed the partnership agreement and executed an amendment thereto, dated July 1, 1944. Margaret admitted that, as donee, she signed the gift tax returns executed by her father and step-mother. Both admitted signing individual income tax returns for 1945 and 1946, reporting their respective shares of partnership income, as reflected on Sherry Enterprises' information returns for its fiscal years ended June 30, 1945, and 1946. Finally, both admitted signing waivers on restrictions on the assessment and collection of deficiencies in tax with respect to their 1945 income tax returns.

Over and beyond the above-described admitted formal partnership acts, Newton's and Margaret's testimony, far from being such as to sustain their burden of proving invalidity, was, at best, self-contradictory. Both taxpayers were confronted with their prior sworn testimony given in connection with their deceased father's 1949 income tax investigation, in which they had stated, under oath, that they were actively participating partners in Sherry Enterprises.

On the precise issue of bona fides which they here deny, Newton's testimony was expressly impeached by his prior sworn statement, in three particulars, and Margaret admitted, on cross-examination that she did not believe the partnership to be a sham tax avoidance scheme; that she did consider it to be a bona fide genuine partnership; and that she considered herself to be a bona fide partner. Furthermore, both children's denials that they performed vital services, contributed capital, or received distributions amounted, at most, to inconclusive self-serving assertions in the light of the record. The Tax Court pointed out that the family partnership's functions as a holding company minimized the performance of services as a key attribute of family partnership status; both Newton's and Margaret's testimony indicated that both may well have contributed inherited capital to the partnership; and both admitted partnership funds had been employed in establishing businesses in which they had variously worked. Margaret admitted her present ownership of certain rental and residential properties which had either formerly belonged to the partnership or possibly been acquired with its funds.

In the context of the case, the admissions contained in the record testimony—coupled with the repeated express acknowledgements of formal partnership organization and operation—more than amply support the Tax Court's conclusion that the taxpayers have here failed to sustain their burden of proving that they were not partners in Sherry Enterprises during

their taxable years, 1945 and 1946. The record sustains the fact finding that they were partners.

ARGUMENT

Under This Entire Record, the Tax Court Correctly Found and Concluded That the Taxpayers Were Partners, for Federal Tax Purposes, In a Valid Family Partnership

The Tax Court correctly found (R. 58) and concluded (R. 60) that, under the entire record, Newton Sherry, the son of Nathan Sherry, deceased, and Margaret Ferguson, the daughter, were partners of Sherry Enterprises, a family partnership, during the taxable years, 1945 and 1946, here involved.[2] This finding is entitled to finality where, as here, it is supported by substantial evidence and is not shown by the taxpayer to be clearly erroneous. *United States* v. *Gypsum Co.*, 333 U.S. 364, 395, rehearing denied, 333 U.S. 869; Section 7482(a) of the Internal Revenue Code of 1954; Rule 52(a) of the Federal Rules of Civil Procedure.

This case does not present the familiar family partnership federal tax issue wherein the burden rests on the [redacted] to show that "considering all the facts * * * the parties in good faith and acting

---

[2] The deficiencies here in issue were assessed against the taxpayers, Newton (who filed joint returns with his wife, Lois Sherry) and Margaret, for their respective calendar years, 1945 and 1946. The additional income, so assessed, represents each taxpayer's additional distributive share of the income of Sherry Enterprises, the partnership, for its fiscal years ended June 30, 1945, and 1946. The amounts of each additional partnership income, as computed by the Commissioner, were not contested. (Stip. par. 2, R. 47.)

with a business purpose intended to join together in the present conduct of the enterprise." *Commissioner* v. *Culbertson*, 337 U.S. 733, 742. Instead, as the Tax Court pointed out (R. 58, 60), it presents the *reverse situation*, namely: present an existing partnership, organized and held out as valid by the taxpayers and other family-members throughout the taxable period, "here it is the partners who have assumed the burden of repudiating their own partnership." *Sherman* v. *United States*, 141 F. Supp. 369, 370 (E.D. Pa.), affirmed *per curiam*, 240 F. 2d 600 (C.A. 3d).

Moreover, the taxpayer-family members' contention that the formal business unit they themselves created cannot constitute a valid family partnership, for tax purposes, becomes irrelevant, and must yield to the practical administrative exigencies, which permit the Commissioner in such circumstances, to take the taxpayer at his word and sustain the representations which the taxpayer himself made to the taxing authorities. *Maletis* v. *United States*, 200 F. 2d 97 (C.A. 9th), certiorari denied, 345 U.S. 924; *Phillips* v. *United States*, 193 F. 2d 132 (C.A. 5th). See also *Higgins* v. *Smith*, 308 U.S. 473, 477; *Moline Properties* v. *Commissioner*, 319 U.S. 436; *Love* v. *United States*, 96 F. Supp. 919, 921 (C. Cls.). As former Chief Judge Denman stated in the *Maletis* case (p. 98):

> The Bureau of Internal Revenue, with the tremendous load it carries, must necessarily rely in the vast majority of cases on what the taxpayer asserts to be fact. The burden is on the

taxpayer to see to it that the form of business he has created for tax purposes, and has asserted in his returns to be valid, is in fact not a sham or unreal. If in fact it is unreal, then it is not he but the Commissioner who should have the sole power to sustain or disregard the effect of the fiction since otherwise the opportunities for manipulation of taxes are practically unchecked. That which best serves the purpose of the tax statute should govern in this field and not the yearly exigencies of this taxpayer. * * *

Taxpayer argues that in fact he could have no election since what he created could never constitute a valid family partnership for income tax purposes. That what he created cannot be a valid family partnership for tax purposes is irrelevant, since he elected to do business as a partnership and represented it to be valid. He elected the form and arrangement in which he would do business. Having adopted that form, even though his actions were so inadequate as to make the form unreal for income tax purposes, "The Government may look at actualities and upon determination that the form employed * * * is unreal * * * may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute." *Higgins* v. *Smith*, *supra*.

We submit the above cited authorities amply support the correctness of the Tax Court's conclusion below (R. 58, 60):

> Here, petitioners seek to disavow the existence of the partnership. The burden of proof is upon them, and we cannot find on this record that it has been carried.
>
> * * * *

> Perhaps, if the burden of proof were on the Government, we would hold in favor of petitioners. But the burden is not upon the Government; it is upon petitioners, and we cannot find from the evidence presented that they were not in fact partners in Sherry Enterprises during the tax years. Accordingly, we have found as a fact that they were partners during the years in controversy.

Cumulatively, the record furnishes, *inter alia*, the following evidentiary support for taxation of these taxpayers as partners in Sherry Enterprises: (1) Taxpayers agree that, on October 1, 1943, the partnership agreement (R. 51-52), giving rise to their respective taxable distributive shares (25 per cent to Newton and 25 per cent to Margaret) was duly executed (Ex. G, Stip. par. 8, R. 48). Newton admitted signing the agreement (R. 86, 92-93) and so did Margaret (R. 110). (2) Taxpayers agree that Nathan and Lucille Sherry, on March 15, 1944, filed gift tax returns for the year, 1943, on which they each reported gifts of one-half of the property transferred to Sherry Enterprises, the partnership. (R. 48-49.) Taxpayers' witness, accountant Herndon Hughes, who prepared the gift tax returns (R. 68-69), admitted on cross-examination, that, at the time of preparation, he believed Sherry Enterprises to be a bona fide partnership (R. 80-81). Newton was not interrogated further about his participation in the transaction. Margaret admitted her signature, as donee, on the gift tax returns (R. 113-114, 124) and her belief that it was not a sham (R. 128). (3)

Taxpayers agree that they signed an amendment (R. 53) to the original partnership agreement, which was dated July 1, 1944, and provided that the firm losses would be borne equally by the parties to the original agreement (R. 48). (4) Taxpayers agree that Sherry Enterprises filed information returns (R. 48) for its fiscal years ended June 30, 1945, and 1946, and that both Newton and Margaret filed individual income tax returns for their calendar years 1945 and 1946 (R. 48), on which returns each reported income of $21,599.28 from the partnership, for 1945, and $19,156.85, for 1946 (R. 53-54). Newton admitted signing his joint return (filed with his wife, Lois) for 1945 (R. 88), and also stated his belief that he signed the return for 1946 (R. 88). Margaret admitted her signature on both of her returns. (R. 114, 116-117, 153.) (5) Both Newton and Margaret admitted their respective signatures on waivers of restrictions on the assessment and collection of deficiencies in tax with respect to their 1945 income tax returns based upon increases in their respective distributive shares of Enterprises' income. (R. 56-57, 59, 100-101, 139-140, 196.) Newton's signed waiver was dated July 19, 1948, and related to an additional assessment of $1,114. (R. 100, 101.) Margaret's waiver, dated September 9, 1948, related to a deficiency assessment of $1,109.75. (R. 139.)

Obviously, the above-detailed and admitted formal acts, performed by taxpayers, evidence the fact that Sherry Enterprises was held out to the Commissioner —agreement-wise, gift tax-wise, and income tax-wise —as a business partnership. Since the family mem-

bers' election to organize as a partnership and to distribute income to named partners during the taxable period was formally subscribed to by the taxpayers themselves, it is clear that, for federal tax purposes, irrespective of the reality and validity of the business form selected, the Commissioner was here entitled to hold the taxpayers to the tax liability attaching to the business unit of their choice. *Maletis* v. *United States, supra; Phillips* v. *United States, supra; Higgins* v. *Smith, supra.* However, the record furnishes additionally compelling support for the correctness of the Tax Court's finding and conclusion.

Faced with the burden of having to prove invalidity of the partnership, the taxpayers attempted to deny: (a) knowledge of the import of their formal partnership actions taken; (b) performance of any significant services to the partnership (R. 59); (c) failure to receive substantial distributions (R. 59-60); and (d) absence of substantial capital contributions. For example, Newton testified, *inter alia*, that: (a) he did not read the partnership agreement (R. 87); did not remember signing any returns for the partnership (R. 87); did not look at the returns he signed (R. 94); never considered himself to be a partner (R. 100); and indicated he depended on his father's instructions as to execution of all pertinent documents (R. 96); (b) he never discussed business with his father (R. 98); and never attended family meetings at which business policies and plans were discussed (R. 98); and only did what his father told him, no matter what it was (R. 108); (c) he never

received any funds from Sherry Enterprises and did not to his knowledge, pay any taxes on income from it (R. 89); and (d) he never personally had any money of his own to invest in the partnership (R. 106).

Considering the burden Newton was attempting to carry by his above-indicated "broad denials" (R. 60), the record does clearly indicate his utter failure to satisfy such burden. The plea of ignorance of the import of his partnership acts, formally performed, does not, of course, absolve him from partnership liability, in any event, but, at best, it is merely self-serving. The Tax Court based its conclusion, in part, upon his conviction that the taxpayers had not (R. 60) "satisfactorily explained away the obvious conclusions to be drawn from these facts" (*viz.*, the formally executed partnership acts, described above). Upon review, due regard should properly be accorded the opportunity afforded the trial court to view the witnesses and judge their credibility. *Quock Ting* v. *United States*, 140 U.S. 417; *United States* v. *Gypsum Co.*, 333 U.S. 364, 395, rehearing denied, 333 U.S. 869; *National Brass Works* v. *Commissioner*, 205 F. 2d 104 (C.A. 9th); *Ferrando* v. *United States*, 245 F. 2d 582 (C.A. 9th). Moreover, here, the record shows, as will be developed, *infra*, that, with respect to at least three material avowments, Newton's credibility was impeached.

As to performance of services, the record shows that, after his discharge from the Marine Corps, Newton worked for a time (R. 90-91, 95-96) as

manager of the Bayview drive-in and bar, at Wilmington, California. The establishment was one of the S & P partnership properties, 50 per cent of which constituted an important component of Nathan's ownership interest contributed as underlying assets of Sherry Enterpries. (R. 51, 90.) For purposes of sustaining the taxpayers' burden of proof, the significance, or insignificance, of the services rendered is in all events, inconclusive. As the Tax Court pointed out (R. 59), the fact that either taxpayer, here, might not have rendered significant services to Sherry Enterprises "is not surprising since it was in the nature of a holding company." (See Witness Hughes' testimony, R. 74-75.) Furthermore, Newton's express denials that: he never considered himself a partner of Sherry Enterprises (R. 98); and never attended meetings and discussed policies and plans of the partnership (R. 98) were specifically impeached and contradicted by his prior sworn testimony given to Special Agent Burns of the Intelligence Division, Internal Revenue Service (R. 184), on November 2, 1949, in connection with the tax investigation of his father, Nathan Sherry. At that time he stated, under oath, that he was a partner (R. 102-103) and, with respect to partnership policy formulation, that he did participate in deliberations "if ever we wanted any type of business whatsoever added to the Sherry Enterprises" (R. 107).

With respect to partnership distributions, the record shows (R. 98-100) that Newton purchased a home for $8,599 in 1946 with Sherry Enterprises' funds and that, subsequent to the taxable period, he

worked at Linda Gale, Inc., a business established for him with Sherry Enterprise funds (R. 99). Finally, with respect to capital contributions, Newton testified to his understanding (R. 105) that $20,000 left by his mother was invested in the family business. This understanding was confirmed by Margaret. (R. 128-129.) However, Newton's express denial (R. 106) that he never had any personal funds of his own to invest in the partnership was impeached and contradicted by his prior sworn testimony of November 2, 1949 (R. 106-107), wherein he stated: "Also, there was money that was left to us that made up the partnership. Also, there was money I invested that made up the partnership."

Following the same broad denial pattern as her brother, Margaret's record testimony similarly evidences a telling failure to satisfy the taxpayers' assumed burden of proof. With respect to each of the above-indicated categories of denial, Margaret testified, *inter alia*, that: (a) she did not recall reading the partnership agreement, when she signed it (R. 111, 125, 127-128); she was not sure (contrary to the stipulation) that she signed the amendment thereto (R. 125-127); she looked at the figures on her tax returns, when she signed, but they did not mean anything (R. 114); she did not understand the significance of the waiver when she signed it (R. 140); she had no knowledge (with one minor exception, R. 147) of what became of the bars and restaurants that were 50 per cent owned by Sherry Enterprises, through S & P (R. 146-149); and she did not have "any feelings about being anything" when she was

returning her reported share of partnership income (R. 154); (b) as to services, she did not undertake to manage Sherry Enterprises and was not consulted (R. 111, 117, 119); her work performed consisted only of answering the telephone and taking messages (R. 130); she had nothing to do with setting business policies (R. 118); and there were no formal meetings to discuss policies, except, perhaps, occasionally at dinner (R. 118); (c) distributions-wise, she never received any income from Sherry Enterprises (R. 122); she never considered she owned any assets personally (R. 131); nothing was left in her father's estate when he died (R. 132, 145); and she never discussed with her brother the reasons why they were not receiving anything from the partnership (R. 151); and (d) as to capital contributions, she endorsed over to her father a $500 check received from her grandmother's estate (R. 119-120, 128); and she understood that $20,000, left to her brother and herself by her mother, was invested for them in the partnership (R. 128-129).

Whereas the foregoing self-serving attempts to deny partnership validity are, in themselves, much too indecisive and indefinite to sustain the burden of proof incumbent upon the taxpayers in this case, they become totally inadequate for such purpose when Margaret's self-contradictory testimony, which stands side by side with them in the record, is examined. For example, she also testified that: despite her protestations of lack of knowledge of the partnership (set forth above) she was aware of the partnership's existence when she signed the partnership agreement

(R. 113); she knew the gift tax return would be filed with the Government and felt, at the time of execution, that it was a true gift and not a sham (R. 128); she knew of no conversations with family members at the time of creation of the partnership which would indicate the partnership agreement was a sham or unreal (R. 155); she did not consider that the partnership was created as a tax avoidance scheme of her father's (R. 154); she considered the partnership to be bona fide and genuine at the time she entered into it (R. 155); during the taxable years under review, she felt she was a bona fide member of Sherry Enterprises (R. 132); and she signed a prior voluntary sworn statement, on May 15, 1940 (R. 141, 142), which contained admissions to the same effect (R. 141-142).

With respect to services performed, she had a joint bank account with her father on Sherry Enterprises' account, went to the bank and cashed checks and made deposits therein (R. 117-118); during 1946, she worked at Sherry Dunn, a perfume business in which the partnership owned an interest (R. 129-130); she was president and a 20 per cent stockholder of Marguery Corporation, which owned Lucy's Restaurant (where she worked) and whose stock she believed to have been purchased by her father with Sherry Enterprises' money (R. 134-135, 136, 143); there were informal meetings of the four partners, sometimes at social gatherings (R. 140); and she signed a prior sworn statement (R. 141, 142), in which she testified under oath in 1950 that she was then a partner in Enterprises (R. 57). Despite her

denial of partnership distributions, she drew checks on Sherry Enterprises' account to pay household expenses of herself and her father when she lived at home (R. 118); during the period under review real estate lots valued at $2,500 and a building valued at $52,500, both of which were Sherry Enterprises' assets, were transferred into her name (R. 130-131); she presently owned a fourplex apartment on North Irving Boulevard, which had formerly been her father's but title to which had been transferred to her, with the source of purchase money being unidentified (R. 136-137); and, in addition, she held title to a triplex apartment, on which she made mortgage payments, but which, at one time, was an asset of Sherry Enterprises (R. 137-138).

Again, with respect to capital contributions, the gift (from her father and step-mother) of her partnership interest was, admittedly, real and genuine (R. 128); she "knew" the $20,000 bequest from her mother "had been left for my brother and I" and understood it was contributed to Sherry Enterprises (R. 128-129); and she personally endorsed over her own $500 contribution to capital (R. 119-120, 128).

Because of the nature of Sherry Enterprises as a family holding company partnership carrying on no real operations of its own (R. 59, 74-75) and with the performance of services not constituting a dominant factor in its successful conduct during the period (R. 59), the testimony of Witnesses Paul Balmanovitz (R. 157-163) and James F. Murray (R. 164-183) added little or nothing to taxpayers' futile attempt to sustain their burden of proof with respect to the

partnership's alleged invalidity. It is entirely irrelevant that Kalmanovitz, as the so-called managing partner (R. 159-163) of S & P, the principal operating partnership, knew nothing of the existence of Sherry Enterprises until the time of the criminal trial of Nathan Sherry, in 1952 (R. 159). It is equally irrelevant that Kalmanovitz' dealings with the Sherry family were almost entirely with Nathan Sherry (R. 158-159, 161), since it is perfectly consistent with the finding of a family partnership (R. 58) that one principal partner should act in a representative capacity for the group, and particularly so, when the partnership is not an operating company, but in the nature of a holding company. As for Murray's testimony, his direct testimony (R. 164-174) reaffirms (R. 164) the fact of the family partnership's organization and existence throughout the taxable period and his testimony on cross-examination (R. 174-181) cumulatively strengthens the claim of its validity since he admitted (R. 175-176) that he had no reason to believe and would not say that Sherry Enterprises was a fictitious partnership. The principal purpose of Government Witness Burns' testimony (R. 184-196) was to lay a foundation for the introduction of the prior sworn contradictory testimony of both taxpayers in connection with the investigation of their father, Nathan Sherry, which testimony was given in 1949 and 1950. It is also to be observed that Burns recommended, on the basis of his examination of the case, that the partnership should be recognized, consistent with the taxpayer's own contentions. (R. 193-194.)

We submit that the foregoing analysis of the record clearly shows that the taxpayers have failed utterly to carry their burden of proving the invalidity of Sherry Enterprises as a family partnership, for federal tax purposes. We submit further that the entire record furnishes more than ample support for the Tax Court's finding that Newton and Margaret were partners in Sherry Enterprises during the years in question. Manifestly, the Tax Court's finding (R. 58, 60) can in no proper view be regarded by a reviewing court as clearly erroneous.

The argument contained in taxpayers' brief (R. 13-19) constitutes a studied refusal to acknowledge both the *reverse* family partnership setting in which the issue of invalidity arises and the resulting burden, which is theirs, of having to prove, by a preponderance of the evidence, such invalidity. As we have already shown, this they have failed utterly to do. Moreover, in such circumstances, the taxpayers' reliance (Br. 13-16) on *Commissioner* v. *Culbertson*, *supra*, and on this Court's decision (Br. 18-19) in *Sellers* v. *Commissioner*, 218 F. 2d 380, is of no help to them. Finally, their attempt (Br. 17-18) to avoid the impact of *Maletis* v. *United States*, *supra*, on the grounds that the father, Nathan Sherry (rather than themselves), was the moving party in organizing the partnership, is, at most, a distinction without a difference. See *Sherman* v. *United States*, *supra*.

CONCLUSION

The decision of the Tax Court should be affirmed.

Respectfully submitted,

CHARLES K. RICE,
Assistant Attorney General.

LEE A. JACKSON,
I. HENRY KUTZ,
DAVIS W. MORTON, JR.,
Attorneys,
Department of Justice,
Washington 25, D. C.

November, 1958.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1958 489057 721